No. 86-1612

IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1986

CONSOLIDATED RAIL CORPORATION,
Petitioner,

v.

ERIE LACKAWANNA INC.,
JOHN HENNING, and VICTOR LASCALA,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

REPLY BRIEF OF PETITIONER

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The Sixth Circuit's Opinion Is Not Confined to "Unique Facts" or "Obsolete Statutes" But Rather Applies to Circumstances Commonly Found in Many Corporate Bankruptcy Proceedings.

Respondent Erie Lackawanna Inc. predictably characterizes the decision below as based upon "unique facts" and "two virtually obsolete statutes," namely the Regional Rail Reorganization Act of 1973 ("Rail Act") and the Bankruptcy Act of 1898. But that portrayal of the Sixth Circuit's decision is as fictitious as the Sixth Circuit's treatment of respondent as comparable to a liquidated company. The Sixth Circuit's opinion reveals

quite clearly that the court did not confine its decision to "unique facts" or base it on "obsolete statutes."

The Sixth Circuit stated:

> ". . . the nature of the restructuring of Debtor [Erie Lackawanna Railway], in which general unsecured creditors became shareholders of Erie Lackawanna, Inc., mitigates against holding Erie Lackawanna, Inc. liable on any claims" (A-2).
>
> * * *
>
> ". . . the new reorganized Erie appears to be a corporation of the creditors, by the creditors and for the creditors" (A-3).
>
> * * *
>
> "In practical terms, Erie's restructuring was similar to a liquidation; the debtor's assets were used to satisfy the claims of creditors, and debtor's previous business (operating a railway line) ceased to exist. All that remained were the non-rail assets." (A-7).
>
> * * *
>
> "By leaving the bare bones of Erie intact, and by providing for the possibility of Erie Lackawanna, Inc.'s continued business existence, these creditors may be able to come out whole" (A-7).

Whatever consideration the Sixth Circuit could have given to the purportedly anomalous circumstances of the Erie Lackawanna bankruptcy reorganization, the Sixth Circuit actually based its decision to immunize respondent from claims on three common occurrences — (1) that the debtor's unsecured creditors became shareholders in the reorganized company, (2) that the reorganized company abandoned its previous business and engaged in new operations, and (3) that the plan approved in the bankruptcy proceeding contemplated a possible post-bankruptcy liquidation of the reorganized company.

Significantly, the brief in opposition does not even attempt to portray the Sixth Circuit's "'hybrid' reorganization-liquidation" as consistent with general principles of bankruptcy law. Rather, respondent argues that the Rail Act gave its reorganization court a latitude that is not enjoyed by any other court in any other reorganization or liquidation under any bankruptcy statute.

According to respondent, its reorganization court's unique authority derived from a Rail Act provision that permitted the court "to reorganize or liquidate such railroad in reorganization pursuant to Section 77 on such terms as the court deems just and reasonable," 45 U.S.C. § 791(b)(4). But what is it that respondent finds to have been "just and reasonable?" A proceeding in which the court sanctioned a corporate form that was neither a liquidation nor a reorganization. A proceeding in which the corporate entity became insulated as of November 30, 1982, from liability on future claims even though the corporate entity continued to have working capital, increasing assets, and corporate tax benefits. A proceeding in which entities, such as Conrail, may find themselves vicariously liable for the reorganized entity's pre-reorganization conduct on claims that had not arisen and could not have been asserted by Conrail or anyone else before November 30, 1982. A proceeding in which the entity can look at its balance sheet as of November 30, 1982, declare its poverty *as of then*, proceed to amass millions of additional dollars, and still cry that it is too poor to compensate the victims of its own previous wrongful conduct. A proceeding in which an allegedly "liquidated" company has publicly traded stock that has increased in value in the past four years from $45 per share (A-234) to $114 per share (*Wall Street Journal*, May 13, 1987), so that any current creditor-shareholders have been "able to come out [more than] whole." According to respondent, Congress and the courts sanction such results as "just and reasonable."

But the terms "just and reasonable" do not confer absolute discretion on reorganization courts. The underlying premises of the Sixth Circuit's decision, (1) that a reorganization in which creditors receive stock in the reorganized company constitutes a liquidation and (2) that claims cannot "ensue" in a liquidation (A-5), are not only fundamental misstatements of existing bankruptcy law but departures with far-reaching consequences. Countless corporations have reorganized and many more will do so pursuant to plans where creditors receive securities instead of cash and where eventual liquidation of the reorganized corporation may be contemplated. In all such cases, the reorganized company, whether just emerging from bankruptcy or years later, can now use the Sixth Circuit's decision to contend that it is not liable for any claims, including claims that were not discharged in its bankruptcy proceeding. Unless this Court grants the petition for a writ of certiorari, the opinion below will inevitably be seized upon by reorganized companies seeking to avoid liability for non-discharged claims.

The decision below immunizes a corporation from liability for existing, non-discharged and unsatisfied claims. Respondent attempts to justify this unprecedented result by arguing that the Sixth Circuit was merely enforcing an allocation of assets that was pre-determined over four years ago although no distribution has yet occurred. Respondent, however, does not and cannot explain how its reorganization court had the unprecedented power to allocate respondent's future earnings for the benefit of some parties, while excluding other parties with non-discharged claims. The reorganization court recognized what the Sixth Circuit did not, that it had such authority only to the extent that it could discharge claims under applicable bankruptcy law. Thus, the sole basis for the reorganization court's injunction against the post-consummation claims asserted by Conrail and respondent's former employees was that

those claims (though non-existent at the time of the consummation order) had been discharged (A-33 to A-36). In so holding, the reorganization court specifically declined to follow the Third Circuit's decision in *Schweitzer v. Consolidated Rail Corp.*, 758 F.2d 936 (3d Cir.), *cert. denied*, 106 S. Ct. 183 (1985). The Sixth Circuit, seeking to avoid a direct conflict with the Third Circuit, did not address the question of the dischargeability of future claims. Instead, the Sixth Circuit chose to give respondent immunity from future claims by devising a " 'hybrid' reorganization-liquidation" concept that has been expressly rejected by the Eighth and Ninth Circuits (*see* Petition for a Writ of Certiorari, at 8-11). However, absent a specific finding of discharge, a court has no power to allocate assets to certain claims and immunize respondent from other claims of comparable or higher priority.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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